




Department of Health Care Services
MEMORANDUM

Date: November 10, 2009

To: John Eastman
Deputy Director
Administration
1501 Capitol Avenue, MS 1000

From: Thomas J. Rakela, C.F.E., Chief Internal Audits
1500 Capitol Avenue, MS 2001
(916) 445-0759 

Subject: Follow-up on the Findings and Recommendations made in our Prior Biennial Report Entitled *Review of the Department's Administrative and Accounting Controls* (07515) – (09004)

Internal Audits has completed its follow-up review of the Findings and Recommendations made in our prior biennial report entitled *Review of the Department's Administrative and Accounting Controls* (07515) issued on December 21, 2007, at the Administration Division. The Findings and Recommendations, the Administration Division's response, and Internal Audits' comments pertinent to their response are contained in the accompanying report.

As part of its operating responsibilities, Internal Audits is responsible for following-up on all inadequacies and weaknesses identified in this audit report. A corrective action plan, including the status of any action taken as well as any planned action, is due within 30 days from the date of this letter. Also, an update should be provided every six months until all corrections have been completed.

Pursuant to the Governor's Executive Order S-08-09, Internal Audits reports will be made available to the public within five working days of finalization. Accordingly, this report will be posted to the internet at <http://reportingtransparency.ca.gov/>.

We appreciate the hospitality and cooperation extended by the Administration Division and hope that the recommendations will benefit your future operations.

John Eastman
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If you have any questions, please call me at (916) 650-0272.

Attachment

cc: Karen Johnson
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DEPARTMENT OF HEALTH CARE SERVICES

I N T E R N A L A U D I T S

**Follow-up on the
Findings and Recommendations
Made in our Prior Biennial
Report Entitled
*Review of the Department's
Administrative and
Accounting Controls (07515)*
November 2009**



09004

**DEPARTMENT OF HEALTH CARE SERVICES
INTERNAL AUDITS**

**FOLLOW-UP ON THE FINDINGS AND RECOMMENDATIONS
MADE IN OUR PRIOR BIENNIAL REPORT ENTITLED
*REVIEW OF THE DEPARTMENT'S ADMINISTRATIVE
AND ACCOUNTING CONTROLS (07515)***

NOVEMBER 2009

**AUDITOR:
PATRICIA PRASAD**

**THOMAS J. RAKELA, C.F.E.
CHIEF OF INTERNAL AUDITS**

ASSIGNMENT NO. 09004

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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

Internal Audits conducted this review to follow-up on the Findings and Recommendations made in our prior biennial report entitled *Review of the Department's Administrative and Accounting Controls* issued on December 21, 2007. The prior report contained 14 findings and 20 recommendations. Each finding was reviewed to ensure that the condition was corrected.

Of the 14 findings and 20 recommendations made in the prior biennial report:

- Nine of the findings and 14 recommendations have been fully implemented. The table below lists those findings and recommendations by transaction cycle:

Transaction Cycle	Finding(s)	Recommendation(s)
Accounts Receivable	1	A, B, C, and D
Fixed Assets and Purchasing	3 and 4	F and G
Revolving Fund	6	I
Human Resources and Payroll	7	J and K
Information Technology Controls	8	L
Disbursements	9 and 10	M and N
Contracts	14	S and T

- One finding is no longer applicable: Finding 13 – Recommendations Q and R. The condition surrounding Finding 13 no longer exists. This finding was related to the inclusion of the prevailing wage provision in a moving service contract. The contract was for a one-time service. Procedures have been implemented to ensure that the prevailing wage provision will be included in future contracts. Recommendations Q and R have been fully implemented.
- Two of the findings have been partially corrected: Finding 2 – Recommendation E and Finding 5 – Recommendation H. These two findings will be repeated in this report.

Finding 2 related to the reconciliation of the physical inventory of fixed assets to the fixed assets ledger. The Asset Management unit (AM) has received the physical inventory records for each division within the Department of Health Care Services (DHCS) and is in the process of completing this reconciliation.

Finding 5 related to the collection of outstanding salary advances. Accounting staff was using an Excel spreadsheet to monitor and collect outstanding salary advances. The Excel spreadsheet was not complete nor did it reconcile to the California State Accounting and Reporting System reports.

- Two of the findings have not been corrected: Finding 11 – Recommendation O and Finding 12 – Recommendation P. Of these two findings, Finding 11 will be repeated in this report. Finding 12 was disclosed in our report entitled *Contract Exemption Review* issued on September 30, 2009; therefore, it will not be disclosed in this report.

Finding 11 related to transactions posted to the Uncleared Collections account. Current transactions posted to Uncleared Collections are reviewed and cleared timely. However, more than half of the transactions posted to the Uncleared Collections were for calendar years prior to 2009.

Finding 12 related to contracts processed and approved after the start of the contract period. Since this finding was disclosed in our report entitled *Contract Exemption Review* issued in September 2009, it will not be repeated here.

No other areas were reviewed and no new conditions were noted during the course of our fieldwork. The detailed findings and proposed recommendations are listed in the Findings and Recommendations section of this report. These findings, recommendations, and your response to our draft report will be incorporated into our Financial Integrity and State Manager's Accountability Act of 1983, also known as FISMA, review, which will be issued later this year.

This report contains an unqualified opinion. We qualified the opinion of our prior biennial report due to the inadequate controls over fixed assets and the untimely clearing of the receivables. Significant improvements have been made so that the conditions considered pervasive in their effects on the accounting and administrative controls have been mitigated.

First, though the general ledger fixed asset totals have not yet been adjusted, AM has the detailed physical inventory records for DHCS. As of October 7, 2009, AM was in the process of reconciling the physical inventory records to the fixed assets ledger.

Second, the receivables were found to be cleared in a timely manner. The prior report stated that outstanding receivables in excess of 120 days total \$27,391,092. As of May 2009, the outstanding receivables in excess of 120 days totaled \$3,150,947. This is a reduction of more than \$24 million, or 88.50%, from our last biennial internal control review.

The findings and recommendations have been discussed with DHCS' Administration Division and applicable program management.

Pursuant to the Governor's Executive Order S-08-09, Internal Audits reports will be made available to the public within five working days of finalization. Accordingly, this report will be posted to the internet at <http://reportingtransparency.ca.gov/>.

AUDITOR'S OPINION

AUDITOR'S OPINION

Internal Audits has made a study and evaluation of the accounting and administrative controls of the Department of Health Care Services (DHCS) in effect as of October 7, 2009. Our study and evaluation was conducted in accordance with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, and included the audit tests considered necessary in determining that accounting and administrative controls are in place and operative.

DHCS' management is responsible for establishing and maintaining adequate internal controls. This responsibility, in accordance with Government Code, § 13402 et seq., includes documenting internal controls, communicating requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures.

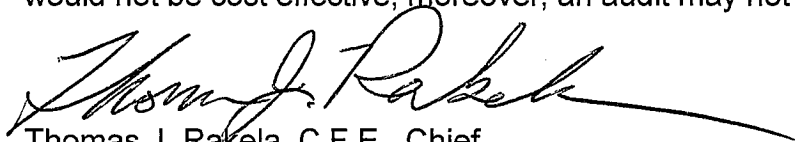
The objectives of accounting and administrative controls are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls. However, we did identify other reportable weaknesses that are described in the Findings and Recommendations section of this report.

In our opinion, DHCS' accounting and administrative controls in effect as of October 7, 2009, taken as a whole, was sufficient to meet the objectives stated above.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls change over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to: resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost effective; moreover, an audit may not always detect these limitations.



Thomas J. Rakela, C.F.E., Chief
Internal Audits

FINDINGS AND RECOMMENDATIONS

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REVOLVING FUND

Finding 1 At least half of the outstanding salary advances for the period prior to July 1, 2007, were not adequately monitored and the collection efforts were not being exercised.

Condition As of July 1, 2007, the California Department of Health Services (CDHS) was split into two departments. CDHS was renamed Department of Health Care Services (DHCS) and the California Department of Public Health (CDPH) was created. Because CDHS was renamed to DHCS, any obligations owed to and by CDHS became the responsibility of DHCS.

The prior State Administrative Manual (SAM) review, noted that CDHS had an outstanding balance of \$270,661 for salary advances. As of April 30, 2009, the outstanding balance was \$158,072. This is a reduction of \$112,589, or 41.60%.

Of the \$158,072, Internal Audits identified that \$32,734 belongs to DHCS and the remaining balance of \$125,338 belongs to the CDHS. Of the \$125,338, DHCS Accounting staff was only monitoring and attempting to collect \$65,649. This was due to DHCS Accounting staff using an Excel spreadsheet prepared by a former employee instead of using the reports generated by the California State Accounting and Reporting System (CALSTARS). The spreadsheet was never reconciled to the CALSTARS report. Once this discrepancy was brought to their attention, Accounting reconciled their spreadsheet to the CALSTARS report. Accounting is now monitoring and attempting to collect the entire salary advance receivable.

Criteria SAM, § 20050, refers to Government Code, § 13403, which states that one of the elements of a satisfactory system of internal accounting and administrative controls shall include:

3. A system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures.

Recommendation A Accounting should use the reports generated by CALSTARS to monitor and collect outstanding salary advances. If another document is used, then it should be reconciled to the CALSTARS report on a monthly basis.

ACCOUNTS RECEIVABLE

Finding 2 More than half of the transactions posted to the Uncleared Collections account are for calendar years prior to 2009.

Condition Transactions currently posted to Uncleared Collections are reviewed and cleared timely. However, as of June 29, 2009, more than half of the transactions posted to Uncleared Collections were posted prior to calendar year 2009. Below is a breakdown of the transactions by calendar year:

Calendar Year	Number of Transactions as of 5/18/09	Number of Transactions as of 6/08/09	Number of Transactions as of 6/29/09
2009	97	32	157
2008	55	53	53
2007	93	93	93
2006	41	41	41
Total	286	219	344
Less 2009	97	32	157
Transactions from 2006 through 2008	189	187	187

As of June 29, 2009, the dollar value of the transactions posted prior to calendar year 2009 was \$348,984.

Accounting stated that due to the limitations of staffing, that the current transactions posted to Uncleared Collections are cleared first. Then, as time permits, the older transactions are cleared; first by highest dollar amount then by date.

However, the longer a transaction sits in Uncleared Collections, the harder it becomes to clear. Supporting documentation may be lost or misplaced. Also, by not clearing the Uncleared Collections, staff may be wasting time trying to collect an Accounts Receivable that has already been paid.

Criteria SAM, § 10452 states that the purpose of the Uncleared Collections account is to show the amount of cash collections which must be reviewed to determine if they are to be accepted for a fund in the State Treasury or are to be refunded to payers.

Recommendation B All transactions posted to Uncleared Collection should be cleared. Ideally transactions should be cleared within 90 days.

FIXED ASSETS AND PURCHASING

Finding 3 The Asset Management unit of the Program Support Branch has not completed the reconciliation of the inventory of physical assets to the fixed assets ledger.

Condition The Asset Management unit (AM) has reconciled the capitalized equipment for each of DHCS' divisions except one, the Information Technology Service Division (ITSD). As of October 7, 2008, ITSD had 56% of the capitalized equipment in both value and number of items (see below).

	Total	ITSD	Percentage
Value	\$7.5 million	\$4.2 million	56%
Items	570	319	56%

ITSD provided AM with its physical inventory of capitalized equipment in June 2009. There were discrepancies between the physical inventory list provided by ITSD and the fixed assets ledger. AM has been working with ITSD to reconcile their physical inventory to the fixed assets ledger.

ITSD indicated that one cause for the discrepancies was the procedures used when disposing of assets. At the time that these assets were disposed, the procedures stated that programs were to contact AM prior to transfer/disposal except when handled through a specific contact such as DHCS' warehouse or the Business Services Unit. ITSD stated that it only disposed of assets through DHCS' warehouse. The procedures "strongly recommended that programs maintain a file of their own transfer or disposal documents." Unfortunately, ITSD did not maintain a file of these documents.

AM has since revised its procedures. Now, when assets are sent to the warehouse, programs are to submit a copy of the Property Transfer Report to AM and the warehouse. However, as of September 2009, these procedures had not been distributed to DHCS' divisions.

Criteria SAM, § 7977 requires the reporting of changes in fixed assets resulting from acquisitions and disposition during the fiscal year.

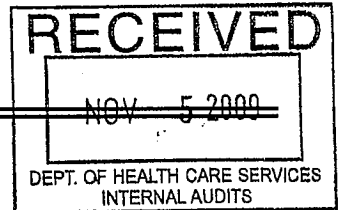
SAM, § 8652 requires departments to make a physical inventory count of all property and reconcile the count with accounting records at least once every three years. It also states that adjustments and reconciliation of the records will take place after the physical count has been completed and that the review and approval of all inventory adjustments will be made by the department director or the director's designee.

- Recommendations**
- C** AM and ITSD should work together to complete the reconciliation of ITSD's physical inventory of their capitalized asset to the fixed assets ledger before the end of the fiscal year. Once the reconciliation has been completed, AM should update DHCS' accounting records so that the value of capitalized assets is properly reflected in the general ledger and in the financial statements.
 - D** To ensure that divisions are following current procedures for managing and maintaining capitalized equipment, AM should distribute its revised procedures to each division immediately.

AUDITEE'S RESPONSE



Department of Health Care Services
MEMORANDUM

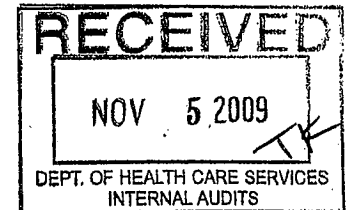


DATE: November 4, 2009

TO: Tom Rakela, C.F.E., Chief, Internal Audits

FROM: John Eastman, Deputy Director, Administration Division

SUBJECT: Responses to 09004 - Draft Report



Tom,

In response to your Draft Report (09004) dated October 20, 2009, for the Follow-up on the Findings and Recommendations made in our Prior Biennial Report Entitled Review of the Department's Administrative and Accounting Controls (07515), we are submitting the attachment with our responses to the three findings for the Administration Division.

If you have any questions or need additional information, please contact Starla Hirst at 552-8533 or Starla.Hirst@dhcs.ca.gov.

Administration Division Responses

Revolving Fund

Finding 1 At least half of the outstanding salary advances for the period prior to July 1, 2007, were not adequately monitored and the collection efforts were not being exercised.

Recommendation A Accounting should use the reports generated by CALSTARS to monitor and collect outstanding salary advances. If another document is used, then it should be reconciled to the CALSTARS report on a monthly basis.

Response Accounting agrees with the recommendation. Accounting staff will reconcile any listing of outstanding salary advances produced on a spreadsheet used to monitor and collect salary advances with the salary advances in CALSTARS on a monthly basis.

Accounts Receivable

Finding 2 More than half of the transactions posted to the Uncleared Collections account are for calendar years prior to 2009.

Recommendation B All transactions posted to Uncleared Collection should be cleared. Ideally transactions should be cleared within 90 days.

Response Accounting agrees with the recommendation. After the department split in July of 2007, a large amount of old items were left in Uncleared Collection which dated several years back. Over the last two years we have cleared out a number of them. But due to their age, research of these items was difficult and documentation hard to find. We agree however, that some items still remain for the prior years and should be cleared. Therefore, we will make a concentrated effort to clear the older items first. We have implemented a procedure of ordering an Uncleared Collections report weekly and the manager identifying the aged items. After which it is distributed to the Cash Receipts Unit Supervisor and the identified items are researched and cleared by the appropriate staff.

Also, efforts were made to try to post directly to the proper receipt code and by pass Uncleared Collections when ever possible, but due to the restriction of the current out dated RPS machine, we were unable to implement this procedure. However, we are currently in the process of purchasing a new more technically

advanced RPS machine, which will allow us to do so. This will reduce the amount of transactions that are posted to Uncleared Collections.

Fixed Assets and Purchasing

Finding 3 The Asset Management unit of the Program Support Branch has not completed the reconciliation of the inventory of physical assets to the fixed assets ledger.

Recommendation C AM and ITSD should work together to complete the reconciliation of ITSD's physical inventory of their capitalized asset to the fixed assets ledger before the end of the fiscal year. Once the reconciliation has been completed, AM should update DHCS' accounting records so that the value of capitalized assets is properly reflected in the general ledger and in the financial statements.

Response Asset Management (AM) agrees with the recommendation. AM will work with ITSD to complete the reconciliation.

Recommendation D To ensure that divisions are following current procedures for managing and maintaining capitalized equipment, AM should distribute its revised procedures to each division immediately.

Response AM agrees with the recommendation. AM is revising procedures to address changes in PSB operations and when completed will distribute to each division.

AUDITOR'S COMMENTS

AUDITOR'S COMMENTS

The Administration Division agrees with all of our recommendations. Internal Audits acknowledges that one of their recommendations requires the Asset Management unit to work with another division within the Department of Health Care Services (DHCS). We appreciate their willingness to work with this other division to implement our recommendation.

Because the reconciliation of the physical inventory of capitalized assets to the fixed assets ledger involves the coordination of all of DHCS' divisions, Internal Audits plans to perform a separate review of this reconciliation at the beginning of 2010.